Let's Get Washington Covered Task Force
Options Relating to Tax Incentives
Task Force Meeting, November 19, 2003

Introduction
The Task Force suggested tax incentives as a strategy to reduce the cost of health insurance.

Are Tax Incentives Feasible?
Tax incentives can be used in Washington State as an element to reduce the cost of health insurance. Significant hurdles and consequences exist when initiating new tax incentives to lessen the cost of health insurance in Washington State:

1. **Tax incentives need to be substantial**
   - In examining potential subsidies, the State Planning Grant reports that recent research suggests that subsidies need to be at least one-half of the cost of health insurance. (Financial Incentives to Employers to Offer Insurance, p. 3)
   - The GAO reports that tax incentives need to be "perhaps half or more" of the cost of health insurance to result in coverage of new individuals. (GAO-02-8 Small Employer Health Insurance.)
   - A Health Services Research paper, 1997, reports that subsidies as high as 75% are needed to increase participation rates among employer-sponsored coverage from 89 to 93 percent. (*The Demand for Health Insurance Coverage by Low-Income Workers: Can Reduced Premiums Achieve Full Coverage?*; *Health Services Research*, Vol. 32, No. 4 (1997), p. 453)
   - Polzer and Gruber demonstrate in *Assessing the Impact of State Tax Credits for Health Insurance Coverage* (prepared in June 2003 for the California HealthCare Foundation) that tax subsides targeted to low-income, small employers are the most efficient tax incentive for covering uninsured individuals. The authors model a tax credit that becomes smaller as both firm size and income increase. Although it fluctuates, the tax credit is substantial with maximum annual subsidies of $1,500 per individual employee and $3,500 for an employee covering a family.

2. **The Business & Occupations (B&O) Tax**
   In discussions with staff from the Department of Revenue, the Business and Occupations Tax (or Public Utilities Tax for public organizations) is likely the only tax available to provide incentives for employers to offer health insurance. A small business tax credit now eliminates the B&O tax for 92,000 businesses and reduces it for another 32,000.

   A substantial tax credit can greatly reduce the B&O tax of an employer:

   a. The B&O tax for retailers is 0.00471 of monthly gross receipts.
   b. $300,000 gross receipts X 0.00471 = $1,413 B&O tax revenue.

c. 10 employees receiving a $50 tax credit = $500 and reduces the monthly B&O tax of the employer to $913.

3. Health Reimbursement Arrangements through Section 125 plans increase federal tax deductions

Since 2001, these plans offer additional federal tax deductions. The tax deductions are, however, tied to prominent federal taxes (e.g., income tax) and are connected directly to the purchase of a health plan. The health plans in Section 125 may not be appropriate for every employer. Similarly, it is unclear whether a tax incentive within the Washington State tax system will apply to a wide audience of employers and employees.

4. Balancing the Washington State Budget

Similar to other states, Washington State will continue to have difficulty balancing its budget in the next legislative session. Any deductions or credits will be hard to come by.

Are There Reasons to Consider Tax Incentives?

Despite numerous consequences, there are reasons to consider tax incentives:

1. Small firms without health insurance pay B&O taxes

The following figures are from the Department of Revenue and list the number of small firms, 1-19 employees, who pay B&O taxes and do not offer health insurance. We do not know how many of these firms may also receive the small employer tax credit or whether these firms pay enough in B&O taxes that a tax credit would be feasible. Yet, they are a potential source for examining incentives.

Construction…………………………15,561

Retail.………………………………..12,833

Accommodation and Food Services….8,267

2. Other states are turning to tax incentives

a. Oklahoma is offering employers a $15 tax credit per eligible employee for two years.

b. Since 2000, Kansas allows employers to receive a $420 per employee per year ($35/month) tax credit for two years, and then a $315 ($26/month) credit for the next three years.

Recommendation

It may be best to assess the success of tax credits implemented in other states before Washington State attempts to design a tax incentive that can decrease the cost of health insurance.